INDEX

	Page
Opinions below	1
Jurisdiction	2
Question presented	2
Statute and regulations involved	2
Statement	4
Argument	9
Conclusion	12

CITATIONS

CASES:

Baumgartner v. *United States*, 322 U. S. 665	12
Burnet v. *Leininger*, 285 U. S. 136	10
Commissioner v. *Sunnen*, 333 U. S. 591	9
Commissioner v. *Tower*, 327 U. S. 280	10
Denholm & McKay Realty Co. v. *Commissioner*, 139 F. 2d 545	11, 12
Douglas v. *Willcuts*, 296 U. S. 1	10
Goodyear Co. v. *Ray-O-Vac Co.*, 321 U. S. 275	12
Harrison v. *Schaffner*, 312 U. S. 579	9
Helvering v. *Clifford*, 309 U. S. 331	10
Helvering v. *Eubank*, 311 U. S. 122	10
Helvering v. *Horst*, 311 U. S. 112	10
Lucas v. *Earl*, 281 U. S. 111	10
Lusthaus v. *Commissioner*, 327 U. S. 293	10
National Carbide Corp. v. *Commissioner*, decided March 28, 1949	9
Raybestos-Manhattan, Inc. v. *United States*, 296 U. S. 60	10
United States v. *Joliet & Chicago R. Co.*, 315 U. S. 44	9
Virginian Ry. v. *Federation*, 300 U. S. 515	12

STATUTE:

Internal Revenue Code, Sec. 22 (26 U. S. C. 1946 ed., Sec. 22)	2

MISCELLANEOUS:

Treasury Regulations 103, Sec. 19.22(a)-20	3
Treasury Regulations 111, Sec. 29.22(a)-19	3

In the Supreme Court of the United States

OCTOBER TERM, 1948

No. 666

BROOKLYN AND RICHMOND FERRY COMPANY, INC.,
Petitioner

v.

COMMISSIONER OF INTERNAL REVENUE

On Petition for a Writ of Certiorari to the United States Court of Appeals for the Second Circuit

---

BRIEF FOR THE RESPONDENT IN OPPOSITION

OPINIONS BELOW

The findings of fact and opinion of the Tax Court (R. 111a-130a)[1] are reported at 9 T. C. 865. The opinion of the Court of Appeals (R. 133-137) is reported at 171 F. 2d 616.

---

[1] "R" references are to the Appendix to taxpayer's brief below as supplemented by the opinion and mandate of the Court of Appeals.

JURISDICTION

The judgment of the Court of Appeals was entered on December 23, 1948. (R. 137.) The petition for a writ of certiorari was filed on March 23, 1949. The jurisdiction of this Court is invoked under 28 U. S. C. Section 1254.

QUESTION PRESENTED

Taxpayer and its sole stockholder contracted with another corporation for a "lease" of the management and control of taxpayer's business, consisting mainly of a ferry franchise and terminals. As consideration the stockholder received from the managing corporation sums not dependent upon taxpayer's income and the managing corporation received from taxpayer management fees, charter hire for boats furnished by it, and dividends. The question is whether the amounts received by the stockholder from the managing corporation are income to the corporation under Section 22 (a) of the Internal Revenue Code.

STATUTE AND REGULATIONS INVOLVED

Internal Revenue Code:

> SEC. 22. GROSS INCOME.
>
> (a) *General Definition.*—"Gross income" includes gains, profits, and income derived from salaries, wages, or compensation * * * or from professions, vocations, trades, businesses, commerce, or sales, or dealings in property, whether real or personal, growing out of the

ownership or use of or interest in such property; also from interest, rent, dividends, securities, or the transaction of any business carried on for gain or profit, or gains or profits and income derived from any source whatever. * * *

(26 U. S. C. 1946 ed., Sec. 22.)

Treasury Regulations 103, promulgated under the Internal Revenue Code:

SEC. 19.22 (a)-20.[2] *Income to lessor corporation from leased property.*—If a corporation has leased its property in consideration that the lessee shall pay in lieu of other rental an amount equivalent to a certain rate of dividend on the lessor's capital stock or the interest on the lessor's outstanding indebtedness, together with taxes, insurance, or other fixed charges, such payments shall be considered rental payments and shall be returned by the lessor corporation as income, notwithstanding the fact that the dividends and interest are paid by the lessee directly to the shareholders and bondholders of the lessor. The fact that a corporation has conveyed or let its property and has parted with its management and control, or has ceased to engage in the business for which it was originally organized, will not re-

[2] These Regulations are applicable to the year 1941. Section 29.22(a)-19 of Treasury Regulations 111, promulgated under the Internal Revenue Code, identical with Section 19.22 (a)-20 of Regulations 103, is applicable to 1942 and 1943 which are also here involved.

lieve it from liability to the tax. While the payments made by the lessee directly to the bondholders or shareholders of the lessor are rentals as to both the lessee and lessor (rentals paid in one case and rentals received in the other), to the bondholders and the shareholders such amounts are interest and dividend payments received as from the lessor and as such shall be accounted for in their returns.

STATEMENT

The facts found by the Tax Court (R. 112a-123a) may be summarized as follows:

Taxpayer, a New York corporation, had the exclusive right to operate ferry boats from Bay Ridge, Brooklyn, New York, to St. George, Staten Island, New York, for a term of twenty years beginning in 1934. The franchise, nonassignable without consent of the City of New York, was subject to cancellation on default of taxpayer including failure to operate the ferries according to a prescribed schedule. The franchise, taxpayer's most valuable asset, has not been conveyed or assigned and is still in force. Without it taxpayer could not have operated a ferry line. (R. 112a.)

During 1939 and all times since, May G. Van Lockhorst, then May G. Schoonmaker, hereinafter referred to as the stockholder, owned all of the outstanding capital stock of taxpayer. (R. 112a-113a.)

Taxpayer had a good location for a ferry business but was mismanaged. About February 1, 1939, a federal inspector issued orders equivalent to condemnation of the boats obtained by taxpayer under bare boat charter. Taxpayer could not comply with the orders of the inspector because of lack of funds and time. Since it was essential that taxpayer make immediate arrangements for ferries to use in the operation of its lines to avoid default, stockholder's attorney, after failing in his effort to have the inspector's orders modified, consulted Electric Ferries, Inc., a New Jersey corporation hereinafter referred to as the management corporation, first with respect to the sale of stockholder's stock to it and then to obtain boats to operate the line. Negotiations resulted in the execution of an agreement in 1939 among the stockholder, taxpayer, the management corporation and stockholder's attorney as escrow agent. (R. 113a-114a.)

In relevant part the agreement provided that taxpayer and its sole stockholder (R. 114a)—

> hereby rent, lease and set over unto the Lessee [the management corporation] and the Lessee does hereby accept, the management and control of the Ferry Company from the Stockholder for the full balance of the term of the said Franchise * * * and for any renewal or extension thereof, as hereinafter provided, and the Lessee agrees to pay to the said Stockholder as an operating expense of the business,

> ten (10%) percentum net, of the gross income from the operation of the said ferry line or business from whatever source derived, payable monthly * * * .

The taxpayer also agreed to "turn over the management and operation of the * * * ferry line to the Lessee * * * to operate under the existing franchise and leases from the City of New York, and any renewals or extensions thereof * * * ." The management corporation agreed to cause the taxpayer to carry out all the liabilities and obligations imposed upon it and to provide management of the ferry line and the necessary ferry boats and crews. The stockholder agreed to put the management corporation in possession of the taxpayer by transferring the ownership of all of her capital stock to the management corporation and placing it in the name of her attorney, Courtland Palmer, as escrow agent. She also agreed to obtain the resignations of each of the existing directors and officers of taxpayer and to elect a board of four new directors, three of whom should be the nominees of the management corporation and one of whom should be the nominee of the stockholder. The management corporation agreed to deposit with the escrow agent the resignation of each of its officers and directors to be used by that agent only in the event of failure to pay the rental to the stockholder or certain other defaults. (R. 114a-117a.)

It was further agreed that the management corporation should be entitled, through its management of the Ferry Company, to possession of the franchise and rights of the Ferry Company and thereby to possession of all of the physical assets of that company for the use and operation thereof. The management corporation agreed to cause the Ferry Company to pay all taxes on its income and all expenses including sums to accrue to the City of New York for the franchise to operate the ferry line. It also agreed to cause the Ferry Company monthly to pay all obligations against it and not to permit any obligations to remain that were over forty days old. The management corporation also agreed to cause the Ferry Company to collect ferry tolls, but the latter was not to pay therefrom any salaries, dividends, or the charter hire due to the management corporation or to pay any other expenses not incurred in the operation of the ferry business until after the monthly payment due to the stockholder. Any dividend checks received by the escrow agent were to be endorsed over to the management corporation "as the owner of the stock held in the name of the Escrow Agent." (R. 117a-119a.)

By amendments of the agreement, the payments by the management corporation to the stockholder were changed on November 10, 1939, so as to provide for an "annual rental" of $24,000 plus 10 percent of all gross income in excess of $400,000 and

later, on December 1, 1941, were further changed so that the "annual rental" was increased to $34,000. (R. 120a.)

During the taxable years, the Ferry Company chartered ferries from the management corporation on a bare boat basis, continued to operate under its franchise, to employ its own crews, and pay its operating expenses, including the cost of repairs to terminals. At undisclosed times, the Ferry Company declared dividends and paid them by check to the escrow agent, who endorsed over the checks to the management corporation. During the years 1939 to 1943 inclusive, the stockholder was paid directly by the management corporation pursuant to the terms of the original agreement and the amendments thereto in the amounts of $18,516.98, $24,000, $37,222.76, $34,000, and $34,000 respectively. The management corporation deducted these amounts as operating expenses for federal tax purposes, the stockholder included them in her income tax returns for the respective years and paid taxes thereon, but those amounts were not reported as income on returns filed by the taxpayer. The income tax returns of the taxpayer showed a net loss in each of the taxable years. It deducted as an operating cost the charter hire of boats paid by it to the management corporation and certain annual sums of about $27,000 as management fees on the part of the management corporation. (R. 120a-122a.)

The Commissioner included in taxpayer's income the amounts paid from 1941 to 1943 to the stockholder by the management corporation. The Tax Court approved the Commissioner's action and the Court of Appeals affirmed, both holding on the authority of this Court's decision in *United States* v. *Joliet & Chicago R. Co.*, 315 U. S. 44, that the amounts paid by the management corporation to taxpayer's stockholder were income to taxpayer because the income was derived from the use by the management corporation of taxpayer's property. (R. 123a-130a, 136-137.)

ARGUMENT

Both of the courts below viewed the agreement among taxpayer, its stockholder, the escrow agent and the management corporation as "in effect a lease of the franchise and managerial rights" of taxpayer to the management corporation (R. 127a, 136) in consideration for which the management corporation made payments to taxpayer's stockholder. So viewed, there can be no question that the payments constituted income to the taxpayer under the basic rule that income is taxable to the one who earns it; and this result may not be avoided by anticipatory arrangement regardless of the form it assumes. *United States* v. *Joliet & Chicago R. Co.*, 315 U. S. 44; *National Carbide Corp.* v. *Commissioner*, decided by this Court March 28, 1949 (slip op. p. 13); *Commissioner* v. *Sunnen*, 333 U. S. 591; *Harrison* v. *Schaffner*, 312 U. S. 579;

Helvering v. *Horst*, 311 U. S. 112; *Helvering* v. *Eubank*, 311 U. S. 122; *Burnet* v. *Leininger*, 285 U. S. 136; *Lucas* v. *Earl*, 281 U. S. 111; Cf. *Raybestos-Manhattan, Inc.* v. *United States*, 296 U. S. 60; *Commissioner* v. *Tower*, 327 U. S. 280; *Lusthaus* v. *Commissioner*, 327 U. S. 293; *Helvering* v. *Clifford*, 309 U. S. 331; *Douglas* v. *Willcuts*, 296 U. S. 1.

We think that a consideration of the involved and somewhat contradictory agreement (R. 38a-63a) leaves little doubt of the correctness of the conclusions below. Both the form and substance of the unique but readily understandable device was that of a lease of taxpayer's management to permit the lessee to exploit taxpayer's nonassignable franchise.[3] The fundamental difference[4] between the taxpayer and the Commissioner is only whether in fact the valuable management rights of taxpayer were leased so that the payments to the stockholder were derived from the taxpayer, as the

---

[3] Taxpayer's argumentative statement of the case (Pet. 4-11) is based in no small part on a highly selective reference to the agreement and on footnote inferences which it draws that were urged upon both courts below and there rejected.

[4] That the disagreement turns on nothing more fundamental than the proper interpretation of a unique agreement was succinctly stated in the opening paragraph of taxpayer's reply brief in the Court of Appeals as follows:

> The difference between the parties may be simply stated. The taxpayer contends the consideration for the payments made by Electric Ferries to Mrs. Van Lockhorst came from her. The Commissioner contends the consideration came from the taxpayer. • • •

Commissioner contends, or whether, contrary to the terms of the agreement and the findings of both courts below, the agreement was a "lease" of the stockholder's stock in taxpayer.[5]

Taxpayer's sole reliance for issuance of the writ, that the decision is in conflict with the decision in *Denholm & McKay Realty Co.* v. *Commissioner,* 139 F. 2d 545 (C. A. 1st), therefore, is without merit. The facts in *Denholm* characterized by the First Circuit (p. 546) as "somewhat peculiar" were that the payments made by the store company (the status of which was somewhat analogous to the management corporation here) to some of the preferred stockholders of the taxpayer were not in consideration of the lease of the taxpayer's property for which the court found that the store company otherwise made full payment, but were occasioned by a guarantee of the dividends on the preferred stock of taxpayer at a time, years before, when the store company owned the shares.[6] Thus,

---

[5] Both courts flatly rejected the "lease" of stock theory. The Court of Appeals (R. 136) stated "the agreement was • • • not in substance or effect a mere lease of the right to vote the stock • • •," and the Tax Court observed (R. 127a) that "The petitioner's idea that the payments related only to a grant of right to vote stock is altogether too narrow, in view of all the facts here involved."

[6] The court stated (p. 547):

> Since all preferred stock of petitioner was issued to the store company in payment for the real estate it seems that the only possible business purpose for the guaranty which the store company executed on the back of such preferred stock certificates was to facilitate the subsequent transfer of this stock by the store company.

to use taxpayer's designation (Pet. 12), the critical feature in *Denholm* that "Corporation B gave to Corporation A no consideration for the payments to the stockholders of B" is not present here because the Tax Court and the Court of Appeals correctly concluded that Corporation B *did* give to Corporation A consideration for the payments to B's stockholder.

The case, then, presents no occasion for issuance of the writ since it is unquestioned that the courts below correctly enunciated the applicable principles of law; the factual findings concurred in by both courts are warranted by the record (cf. *Goodyear Co.* v. *Ray-O-Vac Co.*, 321 U. S. 275, 278; *Virginian Ry.* v. *Federation*, 300 U. S. 515, 542; *Baumgartner* v. *United States*, 322 U. S. 665); there is no conflict of decisions; and the issues presented do not have importance beyond this case.

CONCLUSION

The petition for a writ of certiorari should be denied.

Respectfully submitted,

PHILIP B. PERLMAN,
Solicitor General

THERON LAMAR CAUDLE,
Assistant Attorney General

ELLIS N. SLACK,
IRVING I. AXELRAD,
Special Assistants to the Attorney General.

April 1949

☆ U.S. GOVERNMENT PRINTING OFFICE 1949—832968/P.O. 858